

## CREDIT OPINION

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# Washington (State of)

## Update to credit analysis

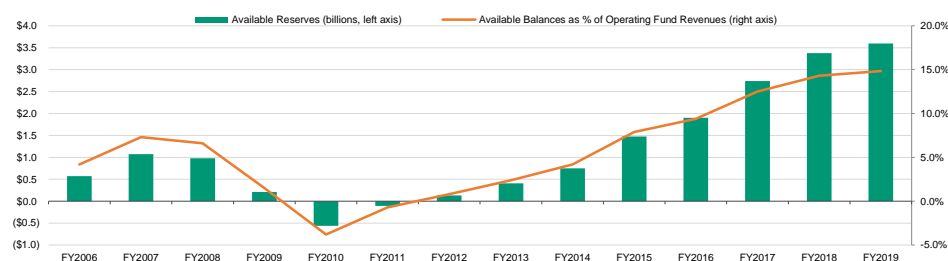
### Summary

The State of Washington's (Aaa stable) credit strength reflects its sizable financial reserves entering the current downturn, the exceptional growth of the state's economy in recent years driven largely by the technology sector in the [Seattle](#) (Aaa stable) metro area, and the consequent economic diversification lessening dependence on aircraft manufacturing by [The Boeing Company](#) (Baa2 negative). Additional strengths include above-average wealth and income levels, and the strong fiscal governance practices. While the state's debt levels are above average, they have been declining relative to the 50-state medians and the state's debt and pension liabilities combined, as well as its fixed costs, are comparable to medians. Frequent voter initiative activity adds budget challenges, but the legislature has broad authority to suspend voter-enacted statutes and a history of responding effectively to maintain budget balance.

Like all US states, Washington is facing a significant shortfall in tax revenues in fiscal 2021 as a result of the coronavirus pandemic. Moody's expects that the shortfall will be addressed by a combination of spending cuts, measured drawdowns of reserves, and federal assistance. We do not see any material immediate credit risks for the State of Washington. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the State of Washington changes, we will update the rating and/or outlook at that time.

Exhibit 1

### Washington built up substantial reserves going into the current downturn



Note: FY2019 available balances include \$981.9 million in the ELTA and OPA; see "Finances and Liquidity".

Sources: State of Washington CAFRs; Moody's calculations.

## Credit strengths

- » Economic and demographic trends are exceptionally strong.
- » Financial reserves and overall liquidity are strong entering the current economic downturn.
- » Pension funding levels are positive and retiree health insurance liability is manageable.
- » Institutionalized governance practices are sound.

## Credit challenges

- » Revenue shortfalls, driven by the current pandemic and economic downturn, will require significant budget actions.
- » Exposure to cyclical commercial aerospace industry and commodity export markets, while reduced, continues.
- » Debt ratios are above average, but have been declining relative to state medians.

## Rating outlook

Washington's outlook is stable, reflecting the positive underlying fundamentals of its economy, sizable reserves entering the current downturn, strong governance practices and manageable long-term liabilities. We expect that the state will continue to address budget gaps that emerge, as it has in the past.

## Factors that could lead to an upgrade

- » Not applicable.

## Factors that could lead to a downgrade

- » A sustained or structural weakening of the state's economy.
- » Protracted structural budget imbalance and/or a shift to reliance on one-time budget solutions.
- » A significant deterioration of the state's cash position.

## Key indicators

Exhibit 2

Washington (State of)	2015	2016	2017	2018	2019	50-State Median (2018)
Operating Fund Revenues (000s)	\$18,789,958	\$20,258,824	\$21,879,055	\$23,551,688	\$24,250,286	\$11,520,082
Available Balances as % of Operating Fund Revenues	7.9%	9.4%	12.5%	14.3%	14.8%	7.4%
Nominal GDP (billions)	\$470.3	\$491.4	\$524.8	\$565.8	\$599.6	\$236.9
Nominal GDP Growth	6.4%	4.5%	6.8%	7.8%	6.0%	4.7%
Total Non-Farm Employment Growth	2.9%	3.1%	2.5%	2.4%	2.0%	1.1%
Fixed Costs as % of Own-Source Revenue	10.5%	10.3%	10.2%	9.0%	NA	8.1%
Adjusted Net Pension Liabilities (000s)	\$22,271,273	\$23,362,109	\$23,975,681	\$22,809,640	NA	\$12,209,760
Net Tax-Supported Debt (000s)	\$19,800,626	\$19,804,130	\$19,711,256	\$19,688,868	\$19,639,634	\$4,146,966
(Adjusted Net Pension Liability + Net Tax-Supported Debt) / GDP	8.9%	8.8%	8.3%	7.5%	NA	7.7%

Note: FY2019 available balances include \$981.9 million in the ELTA and OPA; see "Finances and Liquidity".

Sources: State of Washington CAFRs with Moody's adjustments; Moody's state debt and pension medians reports; US Bureau of Economic Analysis; US Bureau of Labor Statistics.

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## Profile

Washington is the thirteenth largest state by population, at 7.5 million. Its state gross domestic product is twelfth largest, at \$563.2 billion. The population is relatively wealthy, with per capita personal income equal to 113.2% of the US level and a poverty rate in the bottom third among states.

## Detailed credit considerations

### Economy

Washington State experienced exceptionally strong economic growth in the years leading up to the current downturn driven largely by the technology sector centered in and around the City of Seattle. The growth of technology and other sectors has diversified the state's economy and lessened its traditional dependence on aircraft manufacturing by The Boeing Company.

Washington experienced some of the earliest coronavirus cases in the US and was among the first states to implement shelter in place and other restrictions in response to the outbreak. Although data is still limited, these restrictions have had a significant negative impact on the state's economy. Washington's unemployment rate increased from 3.8% in February to 16.3% in April, giving it the 13th highest rate of the 50 states in April. In May, Washington's unemployment rate decreased slightly to 15.1%, but the decrease was less than in other states and its ranking climbed to the 10th highest.

The importance of the tech sector may give Washington an advantage in the economic recovery compared to other states, particularly those more dependent on hard hit sectors like tourism. But the extent of this advantage is unclear at this point. Further, while the state is less dependent on Boeing than in the past, the company's current problems will weigh on the state's recovery. Boeing remains the state's largest private sector employer and an important part of the state's economy and exports. In June 2020, the company announced plans to reduce its overall workforce through a combination of buyouts and layoffs by approximately 16,000 employees, approximately 9,800 of which are expected to be in the state.

### Finances and Liquidity

The state built up sizable financial reserves prior to the current crisis, even as it increased state funding for K-12 education in response to the State Supreme Court's ruling in the "McCleary" case. At the end of fiscal 2019, available reserves totaled \$3,599 million including \$999 million unassigned general fund balance, \$1,618 million in the Budget Stabilization Account, and \$982 million in the Education Legacy Trust Account (ELTA) and the Opportunity Pathways Account (OPA). Total reserves represented 14.8% of operating fund own-source revenues.

Like all states, Washington is facing a significant revenue shortfall in fiscal 2021 due to the pandemic and resulting economic downturn. In its recently-released June forecast, the State Economic and Revenue Forecast Council lowered its estimate of total revenues for the General Fund-State, ELTA and OPA combined for fiscal 2021 to \$23,035 million, a drop of \$3,093 million or 11.8% from the council's June 2019 estimate of \$26,128 million. The fiscal 2021 projection, however, represents a decline of only 3.8% from fiscal 2019 actual revenues, a significantly smaller decline from 2019 than projected by most other states. The difference is in part attributable to the relative stability of property taxes compared to more economically-sensitive taxes such as Washington's sales and business taxes. Property taxes represent approximately 17% of state revenues in the 2019-2021 biennium.

Nevertheless, absent corrective measures, the revenue shortfall would result in a rapid depletion of the state's reserves. The state legislature is expected to meet in a special session to amend the budget for the 2019-2021 biennium in response to the new revenue projections. Moody's expects that the shortfall will ultimately be addressed by a combination of spending cuts, measured drawdowns of reserves, and federal assistance.

### LIQUIDITY

The state's overall liquidity is strong and has improved notably over the last six years with the improvement in its financial position. The state does not issue cash flow notes.

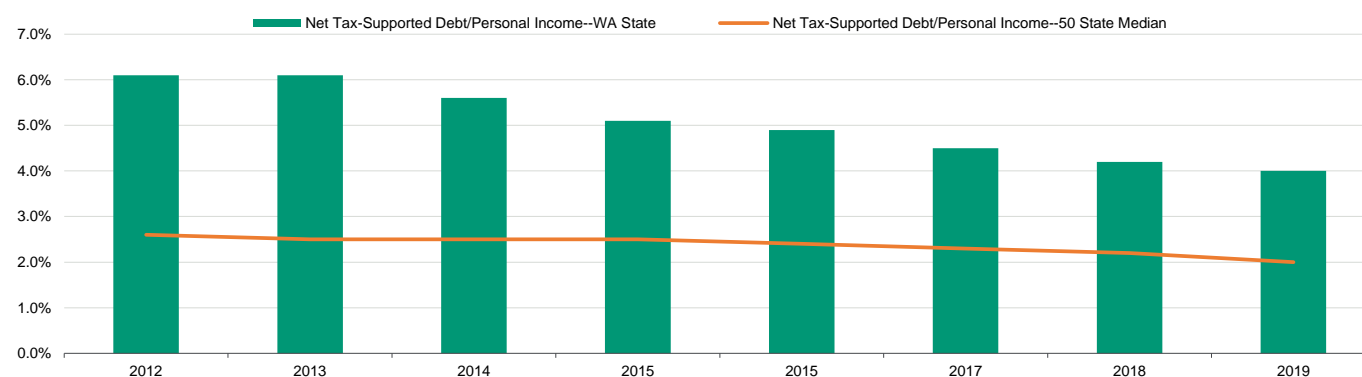
## Debt and Pensions

### DEBT STRUCTURE

Washington's debt consists primarily of general obligation bonds. Moody's calculation of net tax-supported debt (NTSD) includes general obligation bonds additionally secured by and expected to be paid from motor vehicle fuel taxes, but excludes general obligation bonds which are paid from vehicle tolls. The state's debt ratios declined relative to [Moody's 50-State medians](#) for five of the last six years, but remain above the medians: NTSD debt as a percentage of personal income is 4.0%, compared with Moody's median of 2.0%, and NTSD per capita is \$2,579, compared to a median of \$1,071.

Exhibit 3

#### Washington's debt levels have declined relative to Moody's medians



Source: Moody's state debt medians reports.

### DEBT-RELATED DERIVATIVES

The state has no variable rate debt and no debt-related derivatives.

### PENSIONS AND OPEB

While debt ratios are above average, the state's aggregate pension funding is relatively strong. Based on the Washington's fiscal 2018 reporting, Moody's has calculated that the state's adjusted net pension liability (ANPL) was \$22.8 billion or 79.4% of own-source governmental revenues, below Moody's [50-state median](#) of 91.4%. Other pension liability ratios such as ANPL to personal income, GDP, and population, compare favorably to the medians. Notably, fiscal 2017 contributions equaled 116.4% of Moody's Tread Water benchmark. Washington, like all states, remains vulnerable to investment losses in an uncertain market.

In Washington, retiree health benefits are set as part of the biennial budget process and funded on a pay-as-you-go-basis. As of June 30, 2018, the GAAP-basis total OPEB liability was \$5.83 billion. Washington's total fixed costs (debt service plus pension Tread Water plus OPEB contribution) represented 9.0% of own-source governmental revenues, slightly above the 50-state median of 8.1%.

## ESG Considerations

### ENVIRONMENTAL

The US states sector overall has [low exposure](#) to environmental risks because of states' large and diverse economies, revenue-raising ability and [federal government support for disaster recovery costs via FEMA](#). According to data from Moody's affiliate Four Twenty Seven, Washington counties' average projected rate of change in five climate risk factors, when weighted by county GDP, is below average in the nation. King County, which accounts for nearly 50% of the state's GDP, is not projected to have high risk in any of the five climate factors according to Four Twenty Seven's assessment scale. The most significant impact of climate change for Washington may be an increase in the frequency and severity of wildfires. The state budgets a contingent amount for fires each year, but it will continue to depend upon the availability of federal aid through FEMA to mitigate the cost of the largest fires.

### SOCIAL

[Social issues](#), such as demographics, labor force, income and education, are key influencers of the economic and financial factors driving state credit quality. Washington's demographic trends and income levels are generally positive and have contributed to its

strong economic growth, particularly in the Seattle area, where there has been growth in the working-age population supporting growth in high-wage industries. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

**GOVERNANCE**

[Governance](#) is a material consideration for the entire state sector. Washington has strong governance practices including a quarterly consensus revenue forecasting process, multi-year revenue and expenditure projections, timely budget adoption, and a demonstrated willingness to address budget shortfalls. Although frequent voter initiative activity can create budget challenges, the state legislature has broad powers to amend or suspend voter-approved initiatives and a track record of doing so as needed to maintain budgetary balance.

## Rating methodology and scorecard factors

The [US States and Territories Rating Methodology](#) includes a scorecard, which summarizes the 10 rating factors generally most important to state and territory credit profiles. Because the scorecard is a summary, and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not map closely to the actual rating assigned.

Exhibit 4

### US states and territories rating methodology scorecard

Washington (State of)

Rating Factors	Measure	Score
<b>Factor 1: Economy (25%)</b>		
a) Per Capita Income Relative to US Average [1]	114.5%	Aaa
b) Nominal Gross Domestic Product (\$ billions) [1]	\$599.6	Aaa
<b>Factor 2: Finances (30%)</b>		
a) Structural Balance	Aa	Aa
b) Fixed Costs / State Own-Source Revenue [2]	9.0%	Aa
c) Liquidity and Fund Balance	Aaa	Aaa
<b>Factor 3: Governance (20%)</b>		
a) Governance / Constitutional Framework	Aa	Aa
<b>Factor 4: Debt and Pensions (25%)</b>		
a) (Moody's ANPL + Net Tax-Supported Debt) / State GDP [2] [3]	7.1%	Aaa
<b>Factors 5 - 10: Notching Factors [4]</b>		
Adjustments Up: Growth Trend	0.5	
Adjustments Down: Economic or Revenue Concentration or Volatility	-0.5	
<b>Rating:</b>		
a) Scorecard-Indicated Outcome		Aaa
b) Actual Rating Assigned		Aaa

[1] Economy measures are based on data from the most recent year available.

[2] Fixed costs and debt and pensions measures are based on data from the most recent debt and pensions medians report published by Moody's.

[3] ANPL stands for adjusted net pension liability.

[4] Notching factors 5-10 are specifically defined in the US States and Territories Rating Methodology.

Sources: US Bureau of Economic Analysis, State CAFRs, Moody's Investors Service.

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